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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

NO. 191

ROESER & PENDLETON, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND SUPPORTING BRIEF

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PETITION FOR WRIT OF CERTIORARI AND SUPPORTING BRIEF

TO THE HONORABLE, THE SUPREME COURT OF THE UNITED STATES:

A STATEMENT OF THE MATTER INVOLVED

(The opinion of the Circuit Court of Appeals, Fifth Circuit, is reported in 118 F. (2d) 462, also in R. 138-142.)

This petition involves an important Federal question, concerning the right of a lessee, in making a sale of an oil property for a stipulated amount of cash and the retention of an "economic interest" in a

stated portion of the oil and gas in place — in the nature of an overriding royalty, that is free of operating expense — to claim the statutory 27½% depletion allowance on the cash received from such sale, treating such cash "as a return pro tanto of the seller's capital investment in such oil, in anticipation of its extraction." (*Palmer v. Bender*, 287 U. S. 551); with respect to which Federal question, Petitioner submits, the decision of the United States Circuit Court of Appeals for the Fifth Circuit (R. 138-142) is in conflict with the following applicable decisions:

First: Of the United States Court of Claims, in the case of *Heep Oil Corp. v. United States*, 32 Fed. Supp. 762, decided May 6, 1940, and,

Second: Of this Court in the case of *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector Perkins*, 301 U. S. 655, and *Anderson v. Commissioner*, 310 U. S. 404,

in both of which decisions—*Heep Oil Corporation*, 32 Fed. Supp. 762, and *Palmer v. Bender*, 287 U. S. 551 —it was held that where one sells and assigns oil and gas leases for cash and the retention of a stipulated share in the oil and gas in place, or produced, until a stated sum of money is paid therefrom, such retained share constitutes an "economic interest" in the oil and gas in place, and that produced from operation of the leases, which entitles the seller to the statutory depletion allowance, not only on the retained interest, but as well, on the cash payment received, as a return pro tanto upon his invested capital, either actual or based upon discovery value; which holding is in conflict with the decision in the Fifth Circuit Court of

Appeals in petitioner's case, R. 138-142, as its decisions in the *Fleming Case*, 82 F. (2d) 324, and the *Laird Case*, 97 F. (2d) 730.

Third: Of the United States Circuit Court of Appeals, for the Ninth Circuit, in the case of *Elbe Oil Land Development Co. v. Commissioner*, 91 F. (2d) 127, in which this Court granted certiorari (303 U. S. 372; top p. 374) to determine an asserted conflict between the decision in that case, by the Ninth Circuit Court of Appeals, and a decision by the Fifth Circuit Court of Appeals, in the case of *Commissioner v. Fleming*, 82 F. (2d) 324 (see this Court's statement, 303 U. S., top page 374). This Court, in deciding the *Elbe Oil Company Case*, 303 U. S. 372, held that the facts in said case disclosed that the seller retained no "economic interest" in the oil in place, but on the contrary made an outright sale, with respect to which no depletion was allowable. Notwithstanding that this Court disposed of the *Elbe Oil Company Case*, 303 U. S. 372, by holding contrary to the Ninth Circuit Court of Appeals on the *fact issues involved*, the Ninth Circuit Court's opinion upon the *legal question decided*, assuming the facts were present, still stands, and it is in direct conflict with the Fifth Circuit Court's opinion in the *Fleming Case*, 82 F. (2d) 324, and petitioner's case, which is based upon and follows the Fleming Case, supra. (See comment by the Court of Claims in *Heep Oil Corp. v. United States*, 32 Fed. Supp. 762, decided May 6, 1940.)

The following are the salient facts:

On May 29, 1936 (R. 50-54) Roeser & Pendelton, Inc., sold and conveyed to Atlantic Oil Producing

Company, for $400,000.00 cash, but *subject to the oil, gas and mineral reservation next mentioned*, its undivided interests in eleven oil and gas leases, situated in the East Texas oil field, together with its interest in the material, machinery, supplies and other personal property used in connection with the operation of said leases (R. 50-51).

The May 29, 1936 conveyance (R. 50-54) contained the following reservation:

> "Except that Roeser & Pendleton, Inc. does hereby reserve unto itself, its successors and assigns, title to an undivided One-half (½) of the oil, gas and other minerals, in place, under, and produced and saved from the fractional leasehold interests of Roeser & Pendleton, Inc. described in said Exhibit 'A', attached hereto, until the said Roeser & Pendleton, Inc. shall have received from its said reserved undivided interest, as hereinbefore set out, either from all of the leases hereinbefore described, or from one or more of them, as provided for in paragraph twelve of the contract of May 13, 1936 between Roeser & Pendleton, Inc. and R. G. Trippett and A. H. Meadows, hereinbefore mentioned, the sum of One Million Two Hundred Thousand Dollars ($1,200,000.00), in accordance with the terms and conditions of the above referred to agreement of May 13, 1936, between Roeser & Pendleton, Inc. and R. G. Trippett and A. H. Meadows, which said agreement and the rights and privileges therein reserved by the said Roeser & Pendleton, Inc., are incorporated herein by reference and made a part hereof for all purposes, with the same force and to the same extent as if copied herein in full; after the receipt of which said sum of One

Million Two Hundred Thousand Dollars ($1,-200,000.00) said reserved interest shall ipso facto vest in Atlantic Oil Producing Company, its successors and assigns; whereupon, all rights of Roeser & Pendleton, Inc. under said contract of May 13, 1936, shall cease and terminate." (R. 51-52).

Among other covenants and agreements, set forth in said May 13, 1936 Roeser & Pendleton-Trippett and Meadows contract of sale (R. 71-84), referred to in the conveyance above mentioned, which the Atlantic Company bound and obligated itself to perform, and which were made a part, for all purposes, of said May 29, 1936 conveyance (R. 50), were the following:

1. That the assignments executed by R&P, in consummation of the contract of sale, should contain the reservation of title, by R&P in the oil, gas and minerals in place, as above set out. (par. a, R. 77).

2. That the reserved interest of R&P in each of the eleven leases, above mentioned, should continue not only until R&P realized the respective amounts of money, stated in the contract, from the reserved interest, with respect to each group of leases, but as well, until R&P received from all of said reserved interests, a total of $1,-200,000.00. (par. 12, R. 81-82).

3. That the reserved interest of R&P in said eleven leases, should not be liable or responsible for any operation, development or other expenses, except gross production and pipe line taxes, as to which it was agreed the amount of same should not be charged to R&P as having been

received by it on account of its reserved interest. (par. 13, R. 82).

4. That title to the properties covered by the contract might be taken either in the names of Trippett and Meadows, or their nominees and assigns. (par. 17, R. 83).

Messrs. Trippett and Meadows assigned all of their rights under the May 13, 1936 contract with R&P to J. K. Wadley (R. 29-31) who, in turn, assigned all of his interest in same to the Atlantic Company (R. 25-27).

The transaction between R&P and the Atlantic Company was consummated and carried out in accordance with the terms of the agreement. R&P received from the Atlantic Company the $400,000 in cash, as provided, and, from the effective date of said transaction, May 30, 1936, up to and including December 31, 1936, received from the "reserved interest," provided in the agreement, the sum of $69,301.30, less $1,643.09 production taxes, or the net sum of $67,658.21; which amount $67,658.21, was paid direct to R&P by the Pipe Line Company which ran and produced the oil and gas from the properties, pursuant to and in accordance with division orders executed by R&P.

R&P, in its 1936 Income Tax Return, claimed a 27½% depletion allowance on the entire $400,000 cash payment, received by it from the Atlantic Company. It subsequently conceded that this was erroneous, for, not all of the $400,000 received by it, represented an advance payment in anticipation of future production from the undivided leasehold interests sold to

the Atlantic Company, inasmuch as there was included in the sale, all of R&P's interest in the personal property situated on the leases, and used in connection with the drilling and operation of the wells thereon. (R. 102, Issue 2).

R&P, at the time of the sale to the Atlantic Company had invested in such equipment and personal property, after depreciation, previously allowed, a balance of $187,418.23. After deducting this amount from the $400,000 cash amount received, a balance of $212,-581.77 was left, representing, as petitioner views the matter, an advance payment on its reserved interest, in anticipation of future oil and gas produced from the leasehold interest sold and conveyed to the Atlantic Company (R. 40).

The Board of Tax Appeals denied petitioner's claim to the statutory depletion of 27½% on the $212,581.77 balance of the $400,000.00 cash received, (R. 102-103), basing its holding on the cases of *William Fleming*, 31 B. T. A. 623; affirmed Fifth Circuit, 82 F. (2d) 324, and *Roy H. Laird*, 35 B. T. A. 75, affirmed Fifth Circuit, 97 F. (2d) 730 (R. 102).

The U. S. Circuit Court of Appeals, for the Fifth Circuit, on petition to review the decision of the U. S. Board of Tax Appeals, sustained the latter's action in disallowing petitioner the 27½% statutory depletion on the $212,581.77 balance of the $400,000 cash payment received by R&P from Atlantic Oil, citing as authority therefor, *Commissioner v. Fleming*, 82 F. (2d) 324; *Laird v. Commissioner*, 97 F. (2d) 730; *Blankenship v. U. S.*, 95 F. (2d) 507; *Cf. Anderson v. Helvering*, 310 U. S. 404. For decision of Circuit

Court of Appeals see R. 138-142; also reported in 118 F. (2d) 462.

The date of the decision and judgment of the U. S. Circuit Court of Appeals for the Fifth Circuit was March 21, 1941 (R. 138, 143). Its mandate was stayed to June 21, 1941 (R. 147).

JURISDICTION OF THIS COURT TO REVIEW

A review of the Circuit Court of Appeals' judgment is sought by this Petition for Certiorari, under sub. (a) of Section 347, Title 28, U. S. C. A., which provides:

> "In any case, civil or criminal, in a Circuit Court of Appeals, * * * it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, * * * to require by certiorari, either before or after a judgment or decree by such lower court, that the case be certified to the Supreme Court for determination by it, with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal."

The judgment of the Circuit Court was entered March 21, 1941 (R. 143), and the three months' period provided for in Section 350, Title 28, U. S. C. A., for the filing of this petition for certiorari in the Supreme Court, will not therefore expire until June 21, 1941, prior to which date this petition will be filed with the Clerk of this Court.

QUESTION PRESENTED

The sole question presented in this petition for certiorari is whether the U. S. Circuit Court of Appeals for the Fifth Circuit, in its opinion in this case, (R. 140-141) 118 F. (2d) 462, and in the *Fleming*, 82 F. (2d) 324, and *Laird*, 97 F. (2d) 730, cases, has correctly interpreted and applied the "economic interest" depletion rule announced by this Court in *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector v. Perkins*, 301 U. S. 655, and *Anderson v. Commissioner*, 310 U. S. 404.

Under this rule, Petitioner contends that the controlling factor, in determining whether an owner or lessee, who executes or assigns an oil and gas lease, is entitled to the 27½% statutory depletion allowance on the cash received, is the *retention*, by the owner or lessee, of an interest in the minerals which remain to be produced (see Judge Dawkins' opinion in *Palmer v. Bender*, 49 F. (2d) at page 322, which was closely followed by this Court in the same case 287 U. S. 551). It is this *retained interest in the minerals, in place*, or a share in the minerals when produced, that constitutes "an economic interest in the oil, in place," and entitles an owner or lessee, in making a sale, to the 27½% statutory depletion allowance on the cash received.

On the other hand, Petitioner submits, the Circuit Court of Appeals for the Fifth Circuit, has consistently misconstrued and failed to follow the "economic interest" depletion rule, as above interpreted, adopted by this Court in *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector v. Perkins*, 301 U. S. 655, and

Anderson v. Commissioner, 310 U. S. 404, by holding, in the *Fleming Case*, 82 F. (2d) 324, in the *Laird Case*, 97 F. (2d) 730, and in this case 118 F. (2d) 462 (R. 138-142), that the cash received by a lessee, in the sale of an oil property, where the lessee or seller retains an interest in the minerals in place, free of production expense, *constitutes a sale of a capital asset, which is not* subject to the 27½% depletion allowance. For instance, in the *Fleming case*, 82 F. (2d) 324, at page 327, the Fifth Circuit said: "The making of the sale depleted nothing. The money paid did not come actually, or in anyone's contemplation, from the production of oil, but was the purchaser's independent capital invested by him in the oil lease."

This erroneous view and conception of the "economic interest" depletion rule, entertained by the Circuit Court of Appeals for the Fifth Circuit, is diametrically opposed and runs counter to the fundamental logic upon which is based the reasoning of this court in *Palmer v. Bender*, 287 U. S. 551, as reflected in the following quotation from the court's opinion in that case:

> "The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of the discovery rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or *lessee*, or if he leases it to another. It would be an anomaly if that policy were to be defeated and all benefit of the depletion allowance withheld *because he chose to secure the return of his capital investment by stipulating for a share of the oil*

produced from the discovered well through operation by another.

"The bonus received by the Smitherman partnership was a return pro tanto of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced."

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT

Petitioner submits that the "economic interest" depletion rule, announced by this Court in *Palmer v. Bender*, 287 U. S. 551, has been sterilized and rendered impotent by the erroneous construction placed upon it by the United States Circuit Court of Appeals, for the Fifth Circuit. It is therefore of prime importance that this Court should take this opportunity, by granting the petition for certiorari here applied for, to review and place its own construction upon rule announced in *Palmer v. Bender*, supra, rather than to permit the Fifth Circuit to do so; thus dispelling the doubt, confusion and uncertainty that now exists in the minds of lawyers, Auditors and Judges as to the proper construction and application of said rule. For instance, Circuit Judge Foster, dissenting in the *Fleming Case*, 82 F. (2d) 328, said:

> "I think we should go further and allow a deduction for depletion on the cash payment, not dependent on the production of oil, since the taxpayer retained an economic interest in the oil in place; Palmer v. Bender, 287 U. S. 551. I therefore respectfully dissent."

Again, following the Fifth Circuit Court's decision in the *Fleming Case*, 82 Fed. (2d) 324, five members of the United States Board of Tax Appeals in the *Roy Laird Case*, 35 B. T. A. 75, declined to follow the Fifth Circuit's construction of the "economic interest" rule announced by this Court in *Palmer v. Bender*, 287 U. S. 551, their views being expressed in the following quotation from the dissenting opinion. (See 35 B. T. A. at pages 78-79):

> "I think the rule in such cases is that when the taxpayer retains an economic interest in the oil in place, the bonus or cash consideration, from whatever the payor's source, as well as the deferred payments from the oil, are gross income to the owner from that retained economic interest, and are, therefore, subject to the depletion allowance. Palmer v. Bender, supra; Herring v. Commissioner, supra; Burnet v. Harmel, 287 U. S. 103; Welch v. Obispo Oil Co., 61 Fed. (2d) 1045; Helvering v. Falk, 291 U. S. 183; Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886.
>
> "Here the retention of any 'economic interest in the oil in place' may be debatable. However, I agree with the Fleming case and the majority opinion of the Board here that the taxpayer did retain such an interest. Commissioner v. Elliott Petroleum Corporation, 82 Fed. (2d) 193; Chester Addison Jones, 31 B. T. A. 55; aff'd., 82 Fed. (2d) 329; Commissioner v. Williams, 82 Fed. (2d) 328; Alexander v. Continental Petroleum Co., 63 Fed. (2d) 927. *But, since he did retain such an economic interest, I think that the bonus, as well as the deferred payments, were income from the economic interest, and both are, therefore, depletable.*

Palmer v. Bender, supra; Herring v. Commissioner, supra." (Italics ours).

Further, and even more important, the United States Court of Claims, in the case of *Heep Oil Corporation v. United States*, 32 Fed. Supp. 762, on May 6, 1940, held absolutely contrary to the United States Circuit Court of Appeals, for the Fifth Circuit on the question here presented; in fact, refused to follow it; the pertinent portion of the Court of Claims opinion being as follows:

"We are further of the ponion that if it is entitled to depletion, this depletion must be computed with respect to the entire amount paid and not merely on the deferred payments to be made out of the oil produced.

"In Commissioner v. Fleming, 82 F. (2d) 324, the majority of the court in the Fifth Circuit held that depletion should be computed only on the deferred payments, on the theory that that part of the oil out of which the deferred payments were to be made had not been sold. Circuit Judge Foster dissented. The Ninth Circuit, on the other hand, in the case of Elbe Oil Land Development Company v. Commissioner, 91 F. (2d) 127, held that depletion should be computed both on the deferred payments and the cash payment as well. Judge Garrecht dissented, but not on this ground. The Supreme Court reversed the Circuit Court of Appeals (Helvering v. Elbe Oil Land Development Company, 303 U. S. 372, 58 S. Ct. 621, 82 L. Ed. 904), but on the ground that the transaction there was an absolute sale of the leasehold, with no reservations to the grantor of any economic interest in the oil situated thereon.

"If by the instrument in the case before us, properly construed, the plaintiff had conveyed all of the oil except a portion which it reserved to itself, it would follow that it was entitled to depletion only on the oil reserved, but, as we said heretofore, we think the conveyance here was of all the oil, except for the 1/32nd part of that produced from sands below the 3800-foot level. In such case, if plaintiff's net income is to be computed by the deduction of depletion from the amount received, rather than the cost of the property, it must be computed with respect to the entire amount received. The cash payment must be treated as a bonus or advance royalty. Burnet v. Harmel, 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199; Murphy Oil Co. v. Burnett, 287 U. S. 299, 53 S. Ct. 161, 77 L. Ed. 318."

* * * * *

It is significant that the Government did not risk losing what it had won, by the Fifth Circuit's holding in the *Fleming Case*, 82 F. (2d) 324, by applying for certiorari in the *Heep Oil Corporation Case*, 32 Fed. Supp. 762, nothwithstanding the respective holdings, on the identical question, are diametrically opposed.

* * * * *

Furthermore, there still remains undecided, notwithstanding the decision of this Court upon the *fact issues involved* (303 U. S. 372), the conflict between the decision of the Ninth Circuit Court of Appeals, in the case of *Elbe Oil Company v. Commissioner*, 91 F. (2d) 127, and the decision of the Fifth Circuit Court of Appeals in *Commissioner v. Fleming*, 82 Fed. (2d) 324, as well as in petitioner's case, which follows the

Fleming decision, upon the right of a seller to the statutory depletion allowance on a cash payment received, in the sale of an oil property, where the seller retains an "economic interest" in the oil and gas, in place, until a stipulated sum is paid from production.

This Court did not decide this conflict, although certiorari was granted in the *Elbe Oil Company Case* (see 303 U. S., top p. 374) on the ground of an asserted conflict between the decision in that case, by the Ninth Circuit, and the decision in the *Fleming Case*, 82 F. (2d) 324, by the Fifth Circuit. As previously stated, it was unnecessary for this Court to decide the conflict because this court found the facts were dissimilar. However the conflict is clearly raised in petitioner's case, and, if this Court thought it necessary (and it did—see 303 U. S., top page 374) to grant certiorari in the *Elbe Oil Company Case*, supra, to resolve the conflict (which as stated was not later decided because this Court found the facts were different) between the decision in that case, by the Ninth Circuit Court of Appeals, and the decision of the Fifth Circuit Court of Appeals in the *Fleming Case*, 82 F. (2d) 324, this Court should now grant certiorari in petitioner's case to resolve such conflict because petitioner's case follows and is based upon the Fleming Case, supra.

In addition to the foregoing, petitioner feels that the conflict between the decision of the Court of Claims in the *Heep Case*, supra, and the decision of the Fifth Circuit Court of Appeals, in this and the *Fleming Case*, supra, as well as the conflict between the decision of this Court in *Palmer v. Bender*, 287 U. S. 551, and the decision of the Fifth Circuit Court of Appeals in the

Fleming Case, supra, and this case should be resolved because the proper construction and application of the "economic interest" depletion rule, adopted by this Court in the case of *Palmer v. Bender*, 287 U. S. 551, is of such vital importance to the proper administration of the income tax law, with respect not only to the Government, but as well to the taxpayer, it should speedily be clarified and definitely settled; and this can only be accomplished by the granting of this petition for certiorari, and a review by this Court of the question presented.

WHEREFORE, Petitioner prays that, in the exercise of its discretion, this Court may issue its writ of certiorari to review the decision herein of the Circuit Court of Appeals, and for such other orders as may be appropriate.

Respectfully submitted,

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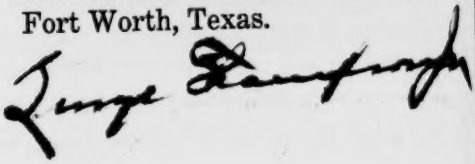

IN THE

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OCTOBER TERM, 1941.

ROESER & PENDLETON, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

THE OPINIONS OF THE COURTS BELOW

The opinion of the Board of Tax Appeals, denying petitioner the right to the statutory 27½% depletion allowance on the balance of $212,581.77, received by petitioner in the sale of its fractional interests in eleven oil and gas leases, wherein it reserved and retained one-half of its said fractional interests in the oil and gas in place, until it received therefrom $1,200,000.00, without charge for operation or production expense, is found in R. 95-105; see R. 102-103 for discussion of particular question here submitted.

The opinion of the Circuit Court of Appeals, Fifth Circuit, affirming the Board of Tax Appeals' decision upon the question here presented, is set out in R. 138-142; also in 18 F. (2d) 462. Inasmuch as the

Circuit Court of Appeals disposed of the question raised in this petition for certiorari, in one short paragraph of its opinion (R. 140-141), it is copied here in full:

> "The taxpayer contends that it should have been allowed statutory depletion of 27½% on the $212,581.77 of the cash payment received by it from the sale of its interest in the oil and gas leases. This contention is also without merit. The Board properly disallowed percentage depletion with respect to the cash payment received by the taxpayer. Commissioner v. Fleming, 82 F. (2d) 324; Laird v. Commissioner, 97 F. (2d) 730; Blankenship v. United States, 95 F. (2d) 507; Cf. Anderson v. Helvering, 310 U. S. 404."

ARGUMENT

After reading the above paragraph from the court's opinion, it is apparent that the Circuit Court of Appeals regarded the question, here raised, as settled by its previous decisions in the *Fleming Case*, 82 F. (2d) 324, and the *Laird Case*, 97 F. (2d) 730. It is true that the *Anderson Case*, 310 U. S. 404, is referred to in the Circuit Court's opinion, as supporting its view, but the Circuit Court in citing it, must not have analyzed or caught the force and effect of this court's holding, because it was one of the chief cases relied upon by petitioner, in the Circuit Court of Appeals, and, instead of upholding the Circuit Court's conclusions, previously expressed in the *Fleming*, 82 F. (2d) 324, and *Laird*, 97 F. (2d) 730 cases, it is, in reality, directly opposed to same.

Inasmuch as the opinion of the Fifth Circuit Court of Appeals in the *Laird Case*, 97 F. (2d) 730, consists of one paragraph in which the court approved, without discussion, on the authority of the *Fleming Case*, 82 F. (2d) 324, the action of the Board of Tax Appeals in denying to the taxpayer the right to claim depletion on a cash payment received in the sale of an oil and gas lease, where the seller retained a stated portion of the oil in place, until a stipulated amount of cash was realized herefrom, it is therefore unnecessary to further refer to the *Laird Case*, supra, inasmuch as the *Fleming Case*, supra, constitutes the "corner stone" of the Fifth Circuit Court of Appeals' unique holding.

Without going into a lengthy discussion of the reasoning of the Circuit Court of Appeals, in the *Fleming Case*, 82 F. (2d) 324, petitioner feels that the Circuit Court's conclusion that a lessee, who sells an oil and gas property, for a cash sum, retaining a specified interest in the oil and gas, in place, until the seller receives, from such retained interest, a designated sum of money, is not entitled to the statutory 27½% depletion allowance, is summarized in the following sentence taken from the Circuit Court's opinion:

> "The making of the sale depleted nothing. The money paid did not come actually or in anyone's contemplation, from the production of oil, but was the purchaser's independent capital invested by him in the oil lease." (82 F. (2d) at page 327).

In this single sentence is contained the truth or error of the logic, upon which is based the Circuit

Court's holding upon the question presented in this petition.

Petitioner says, and believes it can point out in a very simple illustration, that the reasoning of the Circuit Court, above set out is obviously erroneous. For instance, suppose petitioner had sold to the Atlantic Company its fractional interests in the eleven oil and gas leases in the East Texas field (eliminating from consideration the $187,418.23 of equipment and personal property included in the sale), for NO cash, but with the right, on petitioner's part, to receive from its retained interest in the oil and gas, in place, $1,412,581.77, without charge for production or operation expense, then, admittedly, petitioner would have been entitled to the statutory 27½% depletion allowance on the retained $1,412,581.77 of oil and gas, in place, as and when it was produced, because this court so held in the case of *Thomas v. Perkins*, 301 U. S. 655.

On the other hand, assume that Petitioner, instead of making the sale on the basis above outlined (no cash, but with a $1,412,581.77 retained interest in the oil and gas, in place, free of production or operation expense) elected to make the sale for $212,581.77 cash, with the right, on petitioner's part, to receive from its retained interest $1,200,000.00 without charge for production or operation expense, would petitioner, in this situation, be denied the statutory 27½% depletion allowance, which, admittedly it would have been entitled to, in the first instance where no cash was received, merely because, in the second instance, petitioner required the buyer to pay

$212,581.77 in cash, in anticipation of future production, which amount otherwise would have been paid to petitioner from the retained $1,412,581.77 interest in the oil and gas in place, as provided for in the first situation? Would the mere fact that petitioner received from the buyer $212,581.77 in cash, in anticipation of future production of the retained oil and gas in place, invalidate petitioner's right to the statutory 27½% depletion allowance on the cash received?

Expressed in another way, is the right of an owner of an oil and gas property to recover his invested capital in the oil and gas, in place, either actual or based upon discovery value, by claiming the benefit of the statutory 27½% depletion allowance, *dependent* upon the owner's operation and withdrawal of the oil and gas, in place? Or may the owner recover his invested capital, either actual or based upon discovery value, through the statutory 27½% depletion allowance, "by stipulating for a share of the oil produced from the discovered well, *through operation by another?*" (Quotation from *Palmer v. Bender*, 287 U. S. at p. 559).

The questions answer themselves. This Court, in *Palmer v. Bender*, 287 U. S. 551, said:

> "The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of the discovery, rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or lessee, or if he leases it to another. *It would be an anomaly if that policy were to be defeated and all bene-*

fit of the depletion allowance withheld because he chose to secure the return of his capital investment by stipulating for a share of the oil produced from the discovered well through operation by another.

"The bonus received by the Smitherman partnership was a return pro tanto of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced." (Italics ours).

It is therefore apparent that the Fifth Circuit Court of Appeals has completely missed the point stressed by this Court in the above quotation from the opinion of this Court in *Palmer v. Bender*, 287 U. S. 551. The statement, in the opinion of the Fifth Circuit Court of Appeals, in the *Fleming Case*, 82 F. (2d) at page 327, that "the making of the sale depleted nothing; the money paid did not come actually, or in anyone's contemplation from the production of oil, but was the purchaser's independent capital invested by him in the oil lease" is, in a phrase attributed to the present Chief Justice of this Court, "*a tortured construction*" of the opinion of this Court in *Palmer v. Bender*, supra.

It is not, as stated by the Fifth Circuit Court of Appeals' opinion in the *Fleming Case*, 82 F. (2d) at page 327, a question who operates the lease and produces the oil and gas in place; or that the money paid by a purchaser to a seller of an oil property, did not come from the production of oil or gas, but represented the purchaser's independent capital, or that the making

of the sale depleted nothing; these matters are wholly beside the point. *The controlling principle is that the owner of an oil property has invested capital, either actual or based upon discovery value*, in the oil and gas, in place, which he is entitled to have *returned* to him through the medium of the statutory 27½% depletion allowance. It makes no difference whether such owner operates the property himself, contracts for others to do so for him, or sells the property, retaining an interest or share in the oil and gas in place, or as and when produced. In each and every instance, under the decision of this Court in *Palmer v. Bender*, 287 U. S. 551, the owner is entitled to the statutory 27½% depletion allowance. It is only through this medium that the owner's invested capital is *returned* to him. This is the substance of the holding of the United States Court of Claims in *Heep Oil Corp. v. United States*, 32 Fed. Supp. 762, decided May 6, 1940, which is in direct conflict with the holding of the Fifth Circuit Court in the *Fleming Case*, 82 F. (2d) 327.

Let us now review the decision of this Court in *Palmer v. Bender*, 287 U. S. 551, as stated in *Collector v. Perkins*, 301 U. S. 655, and explained in *Anderson v. Commissioner*, 310 U. S. 404, to determine if petitioner's views, above expressed, are sustained by the decisions of this Court, referred to.

In 1937, this Court, in the case of *Collector v. Perkins*, 301 U. S. 655, had occasion to review its opinion, rendered in *Palmer v. Bender*, supra, and with respect to same, said:

"The taxpayer, Palmer, was a member of a

partnership that acquired oil and gas leases, discovered oil, executed a writing conferring on a company the right to take over a part of the leased property in consideration of a present payment of a cash bonus and future payments to be made 'out of one-half of the first oil produced and saved' to the extent of $1,000,000, and an additional 'excess royalty' of one-eighth of all the oil produced and saved. The writing declared that the partnership 'does sell, assign, set over, transfer and deliver * * * unto the' oil company the described leased premises.

"In his tax return, Palmer reported his share of the income derived by the partnership from the bonus payment and oil received under its contract with the oil company and, relying on § 214 (a) (10), made a deduction for depletion based on value of oil in place on the date of discovery. The commissioner refused to allow the deduction on the theory that the transaction was a sale of the leases by the partnership, and that the only allowable deduction was one based upon the cost of the property. As cost was less than the discovery value, the commissioner's allowance of depletion was less than that claimed by Palmer and the tax was correspondingly greater. He paid it, and sued the collector to recover the amount by which the commissioner's ruling operated to increase his burden."

"The district court upheld the commissioner's ruling, the Circuit Court of Appeals affirmed, this Court reversed. We said (pp. 557-558): 'The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal re-

lationship, income derived from the extraction of the oil, to which he must look for a return of his capital. * * * Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. *It is enough if, by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production.* Thus, we have recently held that the lessor is entitled to a depletion allowance *on bonus and royalties*, although by the local law ownership of the minerals, in place, passed from the lessor upon the execution of the lease. * * * Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom * * * were entitled to share in the oil produced.' (Italics ours).

"Thus in that case we held assignors' mere stipulation for royalty out of oil operated to save to them an economic interest in the oil sufficient to entitle them to deduct from their income derived from the oil an allowance for depletion. *If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. Ownership was essential.* The assignee was not entitled to income from Palmer's share of the oil nor to deduct from the income it received from its own interest any part of the depletion allowance that was attributable to Palmer's interest." (Italics ours).

We come now to the case of *Anderson v. Commissioner*, (310 U. S. 404), decided May 20, 1940, con-

taining the most recent expression by this Court upon the question under consideration, although the exact question was not there presented or decided. In the course of his opinion, Justice Murphy, speaking for the Supreme Court, said:

> "*It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable.* That issue is, who has a *capital investment in the oil and gas in place and what is the extent of his interest.* * * *
>
> "*Oil and gas reserves like other minerals in place, are recognized as wasting assets.* The production of oil and gas, like the mining of ore, is treated as an income-producing operation, not as a conversion of capital investment as upon a sale, and is said to resemble a manufacturing business carried on by the use of the soil. Burnet v. Harmel, 287 U. S. 103, 106-107; Bankers Coal Co. v. Burnet, 287 U. S. 308; United States v. Biwabik Mining Co., 247 U. S. 116; Von Baumbach v. Sargent Land Co., 242 U. S. 503, 521, 522; Stratton's Independence v. Howbert, 231 U. S. 399, 414. The depletion effected by production is likened to the depreciation of machinery or the using up of raw materials in manufacturing. United States v. Ludey, 274 U. S. 295, 302-303; Lynch v. Alworth-Stephens Co., 267 U. S. 364, 370. Compare Von Baumbach v. Sargent Land Co., supra, at 524-525. *The deduction* is therefore permitted as an act of grace and is intended as compensation for the *capital assets* consumed in the production of income through the severance of the minerals. Helvering v. Bankline Oil Co., 303 U. S. 362, 366-367. *The granting of an arbitrary deduction,* in the

interests of convenience, *of a percentage of the gross income* derived from the severance of oil and gas, merely emphasizes the underlying theory of the *allowance as a tax-free return of the capital* consumed in the production of gross income *through severance.* Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312, 321; United States v. Dakota-Montana Oil Co., 288 U. S. 459, 467.

"The sole owner and operator of oil properties clearly has a capital *investment in the oil in place,* if anyone has, and so is taxable on the *gross proceeds of production* and is granted a deduction from gross income *as compensation for the consumption of his capital.* See Burnet v. Harmel, supra, at 107-108; Helvering v. Clifford, No. 383, October Term, 1939. By an *outright sale* of his interest for cash, such an owner converts the form of his capital investment, severs his connection with the production of oil and gas and the income derived from production, and thus renders inapplicable to his *situation the reasons for the depletion allowance.* 'The words "gross income from the property," as used in the statute governing the allowance for depletion mean gross income received from the operation of the oil and gas wells *by one who has a capital investment therein,*— not income from the sale of the oil and gas properties themselves.' Helvering v. Elbe Oil Land Co., 303 U. S. 372, 375-376.

"Other situations, falling between the two mentioned, have been put on one side or the other as the cases arose. The holder of a royalty interest—that is, a right to receive a specified percentage of all oil and gas produced during the term of the lease—is deemed to have '*an economic interest*' in the oil in place which is *depleted by severance.*

Palmer v. Bender, 287 U. S. 551, 557; Murphy Oil Co. v. Burnet, 287 U. S. 299; Burnet v. Harmel, 287 U. S. 103. See Lynch v. Alworth-Stephens Co., 267 U. S. 364. *Cash bonus payments, when included in a royalty lease, are regarded as advance royalties,* and are given the same tax consequences. Burnet v. Harmel, 287 U. S. 103; Murphy Oil Co. v. Burnet, 287 U. S. 299; Bankers Pocahontas Coal Co. v. Burnet, 287 U. S. 308. Compare Helvering v. Elbe Oil Land Co., 303 U. S. 372, 375. * * *

"Thomas v. Perkins, 301 U. S. 655, relied upon by petitioners, presented the issue whether the right to oil payments—that is, the right to a specified sum of money, payable out of a specified percentage of the oil, or the proceeds received from the sale of such oil, if, as and when produced — *should be treated for tax purposes like the right to oil royalties* or *like the right to cash payments upon a sale.* In that case, the assignment of lease provided for payments in oil *only without the reservation of a royalty interest.* The question was whether the *assignees'* gross income should include moneys paid to the assignors by purchasers of the oil. We stated (p. 659): 'The granting clause in the assignment would be sufficient, if standing alone, to transfer *all the oil* to the assignee. It does not specifically except or exclude any part of the oil. But it is qualified by other parts of the instrument. The provisions for payment to assignors in oil only, the absence of any obligation of the assignee to pay in oil or in money, and the failure of assignors to take any security by way of lien or otherwise unmistakably show that they intended to withhold from the operation of the grant one-fourth of the oil to be produced and

saved up to an amount sufficient when sold to yield $395,000.' Under these circumstances, the moneys received by the assignors from the sale of the oil *were deemed not to be income to the assignees.* See also Palmer v. Bender, 287 U. S. 551.

"The holder of an oil payment right, as an original proposition, might be regarded as having no capital investment in the oil and gas in place. The value of the right, even though dependent upon the extent of the oil reserves, is fixed at the moment of creation and does not vary directly with the severance of the mineral from the soil. In this sense it resembles the right to cash payments more closely than the right to royalty payments. *Yet it does depend upon the production of oil, ordinarily can be realized upon only over a period of years,* and permits of a simple and convenient allocation between lessor and lessee of both the gross income derived from production *and the allowance for depletion.* Compare Burnet v. Harmel, 287 U. S. 103, 106-107. Accordingly, this Court in Thomas v. Perkins decided that the provision in the lease for payments solely out of oil production should be regarded *as a reservation from the granting clause of an amount of oil sufficient to make the agreed payments,* and should be given the same tax consequences *as a provision for oil royalties.* The decision did not turn upon the particular instrument involved, or upon the formalities of the conveyancer's art, but rested upon the practical consequences of the provision for payments of that type. See Palmer v. Bender, 287 U. S. 551, 555-557; Burnet v. Harmel, 287 U. S. 103, 111." (Italics ours).

Let us now apply the principles of law, announced by this Court in the *Anderson case,* supra, to the facts in

petitioner's case, and determine into which of the following classes petitioner's case falls.

CLASS ONE: In the *Anderson case*, this Court said:

> "*By an outright sale of his interest for cash*, such an owner converts the form of his capital investment, *severs* his connection with the *production* of oil and gas, and the income derived from *production*, and thus renders inapplicable to his situation the reasons for the depletion allowance." (Italics ours).

Certainly petitioner's case does not fall in "Class One"—hence is not governed by the rule which is applicable thereto—because there was *no outright sale* by petitioner, of its entire interest for cash, nor a *severing* of its connection with *production* of oil and gas, and the "*income derived from production.*" On the contrary, petitioner reserved and retained, in the sale to the Atlantic Company, one-half of its former interest in the oil and gas in place, and the *production* therefrom, until it received $1,200,000.00, at which time it was provided title to said reserved interest should ipso facto pass to the Atlantic Company.

CLASS TWO: In the *Anderson case* this Court said:

> "Cash bonus payments, when included in a royalty lease, are regarded as advance royalties and are given the same tax consequences" — Again,
> * * *
>
> "Accordingly, this court, in Thomas v. Perkins, decided that the provision in the lease for payments solely out of oil production should be regarded *as a reservation from the granting clause of an*

amount of oil sufficient to make the agreed payments, and should be given the same tax consequences as a provision for oil royalties." (Italics ours).

Petitioner submits that its case falls in, and is governed by the rule announced in "Class Two," for, if, as stated above, *an oil payment* "should be given the same tax consequences as a provision for *oil royalties*", then an *oil payment* should be treated as a form of "*oil royalty*" for tax purposes; and, since a *cash bonus* payment, where a *royalty* is retained is subject to the 27½ per cent statutory depletion allowance, it follows that a *cash bonus* payment, where *an oil payment* is retained (having the same tax consequences as the reservation of an *oil royalty*), is likewise subject to the 27½ per cent statutory depletion allowance.

* * * * *

Petitioner respectfully submits that when all of the foregoing expressions of the Supreme Court of the United States are considered, the conclusion is inescapable that the reservation by Petitioner of one-half of its interest in the oil and gas leases transferred to the Atlantic Company until it received from the sale of oil and gas produced from said one-half interest the sum of $1,200,000.00, free of expense of production or operation, constituted an economic interest or overriding royalty retained by petitioner in the oil, gas and minerals in and under the ground covered by the leases in question, and that the payment to and receipt by petitioner of $212,581.77 from the Atlantic Company represented, in law, a payment in advance for oil then in the ground, to be produced in the future, in the same

way and manner that a cash bonus paid to the land owner for an oil and gas lease wherein an economic interest (royalty) is reserved to the land owner represents an advance payment made to him for royalty oil to be produced in the future, regardless of whether any oil or gas may or may not thereafter be actually produced. *(Herring v. Commissioner*, 293 U. S. 322.)

While not controlling, petitioner calls attention to the decision of the Supreme Court of Texas in the case of *State v. Quintana Petroleum Co.*, (133 S. W. (2d) 112) decided November 22, 1939, which holds that the reserved interest in oil produced from land until a stipulated amount of money is realized therefrom (in other words "an oil payment") is no different in nature from the ordinary one-eighth royalty interest. The Supreme Court of Texas, in its opinion, said:

> "The 7/32 interest reserved in the lease executed by O'Connor is not different in nature from the ordinary 1/8 royalty interest. The only difference is that it may not endure for as long a period as does the royalty reserved without limitation. Associate Justice Greenwood's opinion in the Hogg-Sheffield case does make mention of the fact that the ordinary 1/8 royalty continues throughout the duration of the leasehold estate, a determinable fee, which may be perpetual, and is therefore a fee simple interest in land. The opinion, however, contains nothing to suggest that a royalty interest, subject to a limitation which may cause it to terminate before the expiration of the leasehold estate, is not an interest in land. * * *
>
> "This court by its refusal of application for writ of error evidenced its approval both of the

judgment and of the determination of the principles of law declared in the opinion of the Court of Civil Appeals in Sheppard v. Stanolind Oil & Gas Co., 125 S. W. (2d) 643, 649. * * *

"In demonstrating that such reserved right to payment out of production is essentially the same as the royalty ordinarily reserved, Chief Justice McLendon, writing the opinion in this case, said:

> 'Inherently, therefore, these sums possess every characteristic of the royalty payments, save only that the former are limited to the quantity of oil actually produced up to the amount equal in value to the stated sums. Both are conditional absolutely upon the fact of production, and both are limited to the amount of production; the former continuing so long as there is production, the latter ceasing when the production reaches the stated amount. For all practical purposes, and viewed in the light of every practical consideration, the interest of the State in the production of 1/6 of 5/6 of the oil, up to the full amount of the stated sum, is essentially and actually in nowise different from its interest under its retained royalty'."

* * * * *

Petitioner respectfully submits that if the following language, contained in the opinion of this Court in *Palmer v. Bender*, (287 U. S. 551, 558), means what it says, then no distinction can be drawn between a landowner's right to the 27½ percent depletion allowance on a cash bonus, received on an oil and gas lease executed by him as lessor, wherein a royalty is retained, although no oil is produced during the tax-

able year from the land covered by the lease—hence, no depletion actually occurs—(*Herring v. Commissioner*, 293 U. S. 322), and the right of a lessee, who transfers his interest in a lease to a third party, reserving an overriding royalty to be paid out of future production free of expense to him, to the 27½ percent depletion allowance on a cash bonus received in the sale. The language referred to in *Palmer v. Bender*, supra, found at page 558, is as follows:

"In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired *an economic interest* in it which represented their capital investment and was subject to depletion under the statute. *Lynch v. Alworth-Stephens Co.*, supra. When the two leases transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, *an economic interest* in the oil, in place, identical with that of a lessor. *Burnet v. Harmel*, supra; *Bankers Pocahontas Coal Co. v. Burnet*, supra. Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partnerships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases

until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletiion according to the peculiar conditions in each case."

In the case now before the Court, petitioner was a lessee. It transferred to the Atlantic Company its undivided interests in eleven oil, gas and mineral leases, and all personal property, reserving and retaining one-half of its former fractional interests in said leases until it received $1,200,000.00 from the sale of oil, gas and minerals therefrom, free of production or operation expense. (Bd. Tax Appeals Findings of Fact, Tr. 100). Petitioner submits that, under the language above quoted in the *Palmer v. Bender* case, this reservation constituted "an economic interest in the oil in place identical with that of the lessor" and, as a result, Roeser & Pendleton, Inc., was entitled to the statutory 27½ percent depletion allowance on the $212,581.77 cash bonus received by it in the same manner that Herring was permitted the 27½ percent depletion allowance on the cash bonus received by him as a lessor, notwithstanding no oil was produced during the taxable year from the land covered by the lease. (*Herring v. Commissioner*, 293 U. S. 322).

It is well settled, under repeated decisions of this Court, that a cash payment or bonus, received by an owner in the transfer of oil and gas rights, is income. In *Work v. Mosier*, 261 U. S. 352, this Court said:

> "It was really part of the royalty or rental in a lump sum or down payment. We do not see how it

can be classified as anything else. It was income from the use of the mineral resources of the land. Of course, it involved a consumption and reduction of the mineral value of the land, but so does a royalty. This is an inevitable characteristic of income from the product of the mine."

The case of *Burnet, Commissioner v. Harmel* (287 U. S. 103), decided November 7, 1932, called for a decision of whether a cash bonus, as distinguished from royalties, should be treated as a gain from the sale of capital assets, or as ordinary income. In deciding the case this court said:

> "The court below thought that the bonus payments, as distinguished from the royalties, should be treated as capital gain, apparently because it assumed that the statute authorizes a depletion allowance upon the royalties alone. * * * But bonus payments to the lessor have been deemed to be subject to depletion allowances under Section 214a (9), Revenue Act of 1924, by Article 216, Treasury Regulations 65, as well as under earlier acts. * * * Bonus and royalties are both consideration for the lease and are income of the lessor. We cannot say that such payments by the lessee to the lessor, to be retained by him regardless of the production of any oil or gas, are any more to be taxed as capital gains than royalties which are measured by the actual production." See Work v. Mosier, 261 U. S. 352, 357-358."

In the case of *Murphy Oil Co. v. Burnet*, (287 U. S. 299), decided December 5, 1932, this Court said:

> "We think it no longer open to doubt that when the execution of an oil and gas lease is followed

by production of oil, *the bonus and royalties paid to the lessor* both involve at least some return of his capital investment in oil in the ground, for which a depletion allowance must be made under paragraph 234. See Burnet v. Harmel, supra. This is obvious where royalties alone are insufficient to return the capital investment. *A distinction between royalties and bonus, which would allow a depletion deduction on the former but tax the latter in full as income, when received, making no provision for a reasonably anticipated production of oil on the leased premsises, would deny the 'reasonable allowance for depletion' which the statute provides.* The harsh operation of such a rule with respect to taxpayers generally is apparrent and is emphasized by the opportunist character of petitioner's argument here. The rule for which it contends can operate to its advantage only if it fortuitously escapes payment of any tax on the bonus payments, which it insists shall be treated as income without the deduction of any depletion allowance." (Italics ours.)

* * * * *

The proposition announced above, in Italics, is equally applicable here; to paraphrase it: a distinction between the $1,200,000.00 retained oil and gas interest, in place, and the $212,581.77 cash payment or bonus, forming the basis of the sale made by petitioner to the Atlantic Company, "which would allow a depletion deduction on the former, but tax the latter in full as income, when received, making no provision for a reasonably anticipated production of oil on the leased premises, would deny the 'reasonable allowance for depletion' which the statute provides."

Again petitioner points out that, under the decision of this court in *Palmer v. Bender*, 287 U. S. 551, in the absence of an *outright sale*, referred to in *Anderson v. Commissioner*, 310 U. S. 404, petitioner was entitled to a *return* through the statutory 27½% depletion allowance, of *its invested capital*, based upon discovery value, in the oil and gas properties sold by it to the Atlantic Company, and, if petitioner elected, as it did, to have the Atlantic Company pay it $212,581.77 cash, in anticipation of future production of that amount from the retained minerals, in place (this cash payment representing a pro tanto return to petitioner of its invested capital, based upon discovery value) petitioner was entitled to the statutory 27½% depletion allowance upon the $212,581.77 cash payment received.

* * * * *

Two further observations and petitioner will conclude this argument:

In the *Fleming Case*, 82 F. (2d) 324, at page 327 the Fifth Circuit Court of Appeals, in its opinion, said:

> "While the contract was phrased as though the lease and all the oil were sold, as though the proceeds were to be paid back to the seller, the real essence of the transaction was that the lease was sold, and all the oil except that whose proceeds were to come to the selling taxpayer. * * * The thing sold for the cash consideration was the lease and all the oil except that so reserved."

Based upon the conclusion just quoted, the Fifth Circuit Court of Appeals proceeded to hold:

> "We think the Board rightly held as to the transactions herein in question that *part* of the income arose from a sale of a capital asset, and was not subject to a depletion allowance, and that *part* of it arose from the operation of the oil wells and was so subject." (Italics ours).

Petitioner construes the above reasoning of the Fifth Circuit Court of Appeals to mean that an *outright sale* was made of the lease and all of the oil in place, except the retained portion, and, as to the *cash received from the outright sale*, it was not subject to the statutory 27½% depletion allowance, because it constituted a sale of a capital asset.

Again petitioner repeats that while this is an ingenious, it is of the same character referred to by this court in *Murphy Oil Co. v. Burnett*, 287 U. S. 299, as an "opportunist argument."

Mr. Justice Murphy, in his very clear opinion in *Anderson v. Helvering*, 310 U. S. 404, stated what constituted an *outright sale* of an oil property in these words:

> "By an *outright sale* of his interest for cash, such an owner converts the form of his capital investment, *severs* his connection with the production of oil and gas and the income derived from production, and thus renders inapplicable to his situation the reasons for the depletion allowance." (Italics ours).

Petitioner submits that, under Justice Murphy's definition of what constitutes an "*outright sale*" of an oil property, the ingenious but tortured reasoning, used by the Fifth Circuit Court of Appeals, in its opinion

in the *Fleming Case*, supra, cannot be sustained, but must be rejected. In fact, it was rejected by the United States Court of Claims in *Heep Oil Corp. v. United States*, 32 F. Supp. 763, decided May 6, 1940.

Hence, again, no matter what turn the argument takes, one is relentlessly driven back to the fundamental truth, expressed in this Court's opinion in the *Palmer v. Bender Case*, 287 U. S. 551, in these words:

> "Lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if, by virtue of the leasing transaction, he has *retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production.*" (Page 557) * * *
>
> "The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of discovery, rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or *lessee*, or if he leases it to another. It would be an anomaly if that policy were to be defeated and all benefit of the depletion allowance withheld *because he chose to secure the return of his capital investment by stipulating for a share of the oil produced from the discovered well through operation by another. The bonus received by the Smitherman partnership was a return pro tanto of the petitioner's capital investment in the oil, in anticipation of its extraction*, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced." (pages 558-559).

So, in petitioner's case, the $212,581.77 received by petitioner in the sale made to Atlantic Company, constituted "a return pro tanto of petitioner's capital investment in the oil, in anticipation of its future extracton, thus entitling petitioner to the statutory 27½% depletion allowance.

* * * * *

Only one further reason for denying petitioner the benefit of the "economic" interest rule, under this Court's decision in *Palmer v. Bender*, supra, requires answer. The Fifth Circuit Court of Appeals in the *Fleming Case*, 82 F. (2d) at page 327, said:

> "In Palmer v. Bender, however, the transferor reserved an *additional royalty*, and so was in reality a sublessor, and the cash paid him could more readily be treated as a bonus or advance royalty." (Italics ours).

Petitioner submits that the reason above assigned by the Fifth Circuit Court of Appeals, for not applying to the *Fleming Case*, 82 F. (2d) 324, the "economic interest" depletion rule, approved in *Palmer v. Bender*, 287 U. S. 551, is indeed strained. It so happened in the *Palmer v. Bender Case* that the lessees, in transferring to the Ohio Oil Company a part of the leased property, on which the producing well was located, in addition to requiring the Ohio Oil Company to make a cash payment (called a "cash bonus"), and to make a future payment "out of one-half of the first oil produced and saved," to the extent of $1,000,000.00, retained an "excess royalty" of one-eighth of all the oil produced and saved, whereas, in the *Fleming Case*, and in petitioner's case, only a cash payment and a future pay-

ment out of a stipulated interest in the oil and gas, produced and marketed in the *Fleming Case*, and in place, in petitioner's case, was provided for.

However, as above suggested by petitioner, a construction of this Court's opinion in *Palmer v. Bender*, supra, which limits and restricts its application to cases where an *excess royalty is provided for*, in addition to the cash payment, and the retention by the seller of a stipulated interest in the oil and gas in place, and an equivalent share in the oil and gas produced, until a stated amount of money is received by the seller, is not only narrow but constitutes a strained construction of this Court's holding in the *Palmer v. Bender Case*, supra.

Petitioner submits that this Court never intended that the word "royalties," used in its opinion, should be confined and limited to a *technical royalty*, but, on the contrary, should embrace and include any character of interest in the minerals reserved and retained by a seller, and especially where, as in petitioner's case, the purchaser was required to pay the production and operation expense. As a matter of fact, this would in itself make such retained interest a royalty. So that this court may have before it what was said concerning royalties in its opinion in the *Palmer v. Bender case*, supra, the following paragraph is copied:

> "When the two *lessees* transferred their operating rights to the two oil companies, whether they became technical sublessors or not, *they retained by their stipulation* for royalties, an economic interest in the oil, in place, identical with that of a lessor. Thus, throughout their changing relation-

ship with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partnerships, and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time, from the date of the leases until complete extraction, would have resulted in loss to the partnerships. *Such an interest*, is we think, included within the meaning and purpose of the statute permitting deduction, in the case of oil and gas wells, of a reasonable allowance for depletion according to the peculiar conditions in each case." (287 U. S., at page 558).

"The statute makes effective the legislative policy, favoring the discoverer of oil by valuing his capital investment for purposes of depletion at the date of the discovery rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or lessee, or if he leases it to another. It would be an anomaly if that policy were to be defeated and all benefit of the depletion allowance withheld, because he chose to secure the return of his capital investment by stipulating for a share of the oil produced from the discovered well through operation by another.

"The *bonus* received by the Smitherman partnership was a return *pro tanto* of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding *diminution in the unit* depletion allowance upon the royalty oil *as produced.* Compare Murphy Oil

Co. v. Burnet, supra." (287 U. S., at pages 558, 559).

As indicating that this Court, in *Palmer v. Bender*, supra, meant to include in the term "royalty" the seller's retained interest in the oil and gas in place, regardless of whether same constituted a technical royalty, an oil payment, or something else, petitioner quotes the following paragraph from the decision of this court in *Thomas v. Perkins*, 301 U. S. at page 661:

> "If Palmer had retained *no interest* in the oil he would have been entitled to *no deduction* on account of depletion. *Ownership was essential.* The assignee was not entitled to income from Palmer's share of the oil nor to deduct from the income it received from its own interest any part of the depletion allowance that was attributable to Palmer's interest."

Petitioner submits that it is crystal clear that this court in *Palmer v. Bender*, supra, *Thomas v. Perkins*, supra, and *Anderson v. Helvering*, supra, did not intend to restrict the right of a seller of an oil and gas property to a return of his capital investment, either actual or based upon discovery value, to instances where the seller, in addition to a cash payment and a retention of a stipulated interest in the oil and gas in place, reserved an interest in a *technical royalty;* But, on the contrary intended by the use of the term "royalty" to include every situation where a seller in making a sale, retained an interest in the oil and gas in place, or provided for payments to be made to him solely from the production of oil and gas. Expressed in another way, the right of an owner of an oil and

gas property to a return of his invested capital is not limited to cases where the seller reserves an interest in the landowner's royalty, in addition to retaining an interest in the oil and gas in place and the production arising therefrom (this Court so held in *Thomas v. Perkins*, 301 U. S. 655). This conclusion is in harmony with the following statement of this court in *Helvering v. Elbe Oil Company*, 303 U. S. 372, at page 375:

> "We are unable to conclude that the provision for this additional payment qualified in any way the effect of the transaction as an absolute sale or was other than a personal covenant of the Honolulu Company. See Helvering v. O'Donnell, ante, p. 370. In this view, neither the cash payments nor the agreement for a share of subsequent profits constituted an advance royalty, or a 'bonus' in the nature of an advance royalty, within the decisions recognizing a right to the depletion allowance with respect to payments of that sort. Such payments are made to the recipient as a return upon his capital investment in the oil or gas in place."

It is pertinent to here state that this court granted a petition for certiorari in the *Helvering v. Elbe Oil Co. case*, supra, "Because of an asserted conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Commissioner v. Fleming*, 82 F. (2d) 324. (See statement in this court's opinion, 303 U. S. at top page 374.) However, upon a review of the facts involved in the *Elbe Oil Company case*, this court held that the cash payments stipuatel to be made by the buyer to the seller were not coupled with any reten-

tion by the seller of any interest in the oil and gas in place; hence the transaction there constituted an absolute sale of all of the properties in question, including all the oil and gas in place, with no retention by the seller of any interest therein.

Petitioner respectfully submits that if this court granted a petition for certiorari in the *Elbe Oil Company case* to determine an asserted conflict with the decision of the Fifth Circuit Court of Appeals in the *Fleming case*, 82 F. (2d) 324, it is reasonable for petitioner to request that its petition for certiorari in this case be granted, to resolve an asserted conflict between the decision of the Fifth Circuit Court of Appeals in the *Fleming Case*, 82 F. (2d) 324, and the decision of the United States Court of Claims in the *Heep Oil Corporation case*, 32 F. Supp. 762, as well as to resolve a conflict between the decision of said Circuit Court of Appeals in the *Fleming case*, supra, and of this court in the *Palmer v. Bender case*, supra.

Petitioner cannot understand how anyone can read this Court's opinion in *Palmer v. Bender*, 287 U. S. 551, and in *Anderson v. Commissioner*, 310 U. S. 404, and fail to be indelibly impressed with the following *fundamental and controlling principles* there announced.

1. The right of an owner of oil and gas in place, who is entitled to share in its production, to have returned to him his capital investment, either actual, or upon a discovery value, as he may elect, through the medium of the statutory depletion allowance; and,

2. Where the owner sells his property, for a stipulated amount of cash, and at the same time retains a

stated interest in the oil and gas in place, until an agreed amount of money is received therefrom, he has such an "economic interest" in the minerals, represented by his capital investment in the oil and gas, in place, as entitles him not only to a *return of his capital investment,* through the statutory depletion allowance on the retained interest in the minerals in place, but as well, the cash payment or bonus received, because, as stated by this Court in *Palmer v. Bender*, 287 U. S. at page 559:

> "The bonus * * * was a return *pro tanto* of the petitioner's capital investment in the oil, in anticipation of its extraction."

It is not too much to state that this Court never intended to have its holding in the *Palmer v. Bender, Case* confined and limited to instances where the seller retained an *excess royalty* in addition to a retained interest in the oil and gas in place. This indeed, would be a narrow construction, and would constitute an open invitation to owners of oil properties in making a sale for cash and a retained interest in the oil and gas, in place, to also reserve an inconsequential excess royalty, say 1/10,000th, so as to be assured that, by so doing, they would bring themselves within the narrow confines of the *Palmer v. Bender Case*, with respect to taking the statutory depletion on the cash received.

* * * * *

On the other hand, if the Fifth Circuit Court of Appeals, has correctly construed this Court's holding in the *Palmer v. Bender Case*, as requiring the retention by the seller of *a technical royalty interest*

in the minerals, in place, in order to be entitled to the statutory depletion allowance on the cash payment received by the owner, in making a sale of his oil property, then petitioner submits that the interest retained by it, in the oil and gas in place, in the sale made by it to the Atlantic Company, constituted *an overriding royalty*, because it was not charged with any expense of production, or operation. In fact, a typical division order, under which petitioner received payment for its reserved interest, referred to same as "ORI" (overriding royalty interest). (R. 88).

Furthermore, as hereinbefore pointed out, while not controlling, the Supreme Court of Texas, in *State v. Quintana Pet. Co.*, 133 S. W. (2d) 112, has held that a reserved interest in oil produced under a lease until a stipulated amount of money is paid, is no different in nature from the one-eighth royalty interest, and we are confident that, if this point is pertinent to a proper decision of the question presented by this petition for certiorari, this court will hold likewise.

CONCLUSION

Upon a considration of this petition for certiorari, this Court is chiefly concerned in determining:

First: Whether the Circuit Court of Appeals, in this case has rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter? (Rule 5-b). It has, assuming that the decisions of the United States Court of Claims are regarded by this Court as possessing equal force with those of the Circuit Court of Appeals, for in the case

of *Heep Oil Corp. v. United States*, 32 F. Supp. 762, the Court of Claims not only declined to follow, but held contrary to, the Fifth Circuit Court's opinion in the *Fleming Case*, 82 F. (2d) 324, upon which its decision in this case is predicated. A clear conflict is therefore presented.

Second: Whether the Circuit Court of Appeals, in this case, has decided a Federal question in a way probably in conflict with applicable decisions of this Court? (Rule 5-b). It has, by misconstruing and not applying the "economic interest" depletion rule approved by this Court in the case of *Palmer v. Bender*, 287 U. S. 551, as explained in *Thomas v. Perkins*, and *Anderson v. Commissioner*, 310 U. S. 404.

Third: Whether there still remains undecided a conflict between the decision of the Ninth Circuit Court of Appeals, in the *Elbe Oil Company Case*, 91 F. (2d) 127, decided by this Court, in 303 U. S. 372 by distinguishing the facts—and the decision of the Fifth Circuit Court of Appeals in the *Fleming Case*, 82 F. (2d) 324, which was adopted and followed in petitioner's case, upon the legal question, involved in both cases, to-wit: whether a seller is entitled to statutory depletion allowance on a cash payment received, where the seller retains an "economic interest" in the oil and gas, in place, until a stipulated sum is paid from production. The Ninth Circuit Court of Appeals, in the *Elbe Oil Company Case*, supra, held he *was* entitled to the depletion allowance on the cash payment, and the Fifth Circuit Court of Appeals, in the *Fleming*, the *Laird* cases, and in petitioner's case, held he was *not*. The Supreme Court did not decide this conflict, present-

ed in the *Elbe Oil Company Case*, 303 U. S. 372, notwithstanding certiorari was granted on the ground of such asserted conflict. (See Court's comment, 303 U. S., top p. 374). As stated, this Court held the facts in the *Elbe Oil Case* were different from those in the *Fleming Case*. Hence it was not necessary for this Court to decide the conflict.

Petitioner calls attention to the case of *Berry Oil Co. v. United States*, 25 Fed. Supp. 97, decided by the Court of Claims on January 9, 1939, in which this court denied certiorari on May 22, 1939. The facts in this case were quite like those in Elbe Oil Company, 303 U. S. 372, in that both presented situations where the seller retained no interest in the oil and gas in place, until a stipulated sum was paid therefore by production. In both cases, there was an *outright sale, with no reservation of minerals.* Hence, the denial of certiorari by this Court in the *Berry Oil Company case*, 25 Fed. Supp. 97, has no bearing upon what action this Court should take in petitioner's case.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, that the Petition for Writ of Certiorari should granted, and upon final hearing, the decree of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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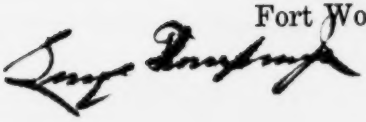

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CITATIONS

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401372—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 191

ROESER & PENDLETON, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 95–105) is not reported. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 137–140) is reported in 118 F. (2d) 462.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 21, 1941 (R. 140–141). The petition for a writ of certiorari was filed June 19, 1941. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner transferred certain oil leases in consideration of $400,000 in cash and the reservation of a specified fraction of the oil in place until it should realize an additional $1,200,000 from the production of oil out of the reserved interest. Is petitioner entitled to the statutory 27½% depletion allowance with respect to any part of the $400,000 cash payment?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.
>
> * * * * *
>
> (b) *Basis for Depletion.*—
>
> (1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.
>
> * * * * *
>
> (3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year,

excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

STATEMENT

In 1931, petitioner, a Delaware corporation, purchased an undivided one-half interest in 10 oil, gas, and mineral leases, and an undivided one-fourth interest in an additional lease, making 11 leases in all, covering lands in Gregg and Upshur Counties, Texas, in what is known as the East Texas Oil Field. On May 13, 1936, petitioner entered into a contract with R. G. Trippett and A. H. Meadows to sell to them, for a total of $400,000 in cash, its undivided interests in the 11 oil, gas, and mineral leases, and all of its interest in the equipment and personal property situated on the property. By the terms of the contract, however, the petitioner reserved title to one-fourth of seven-eighths of the oil, gas, and minerals in place, and produced and saved from 10 of the leases, until it realized from the sale of oil and gas produced from the reserved one-fourth interest, at the then current market price, a total of $1,130,000; and, with respect to the eleventh lease, petitioner reserved the title to one-

eighth of seven-eighths of the oil, gas, and minerals in place, and produced and saved from the eleventh lease, until it realized from the sale, of oil and gas produced from the reserved one-eighth interest, at the then current market price, the sum of $70,000. Following the receipt by the petitioner of the $1,130,000 plus $70,000 (totaling $1,200,000) from the oil and gas produced from the reserved interests in the 11 leases, the title to the reserved interest was to vest in the purchasers (R. 97–98).

Trippett and Meadows assigned all of their rights under the May 13, 1936, contract to J. K. Wadley, who, in turn, assigned his interest to Atlantic Oil Producing Company (R. 100).

The transaction between petitioner and the Atlantic Oil Producing Company was consummated in accordance with the terms of the agreement. Petitioner received from Atlantic Oil Producing Company the $400,000 in cash, as provided therein, and, from the effective date of the transaction, May 30, 1936, up to and including December 31, 1936, petitioner received from the "reserved interest" provided in the agreement the sum of $69,301.30, less $1,643.09 production taxes, or the net sum of $67,658.21. This amount was paid directly to it by the Pipe Line Company which ran and produced the oil and gas from the properties, pursuant to and in accordance with division orders executed by petitioner. (R. 100–101.)

In its 1936 income tax return, petitioner claimed as a deduction from gross income a depletion allow-

ance of 27½% on the entire $400,000 cash received from the Atlantic Oil Producing Company. It also claimed, on its return, depletion at the rate of 27½% on the gross amount of $69,301.30 received from the "reserved interest." The Commissioner disallowed any depletion deduction on the $400,000 cash payment but allowed percentage depletion on the $69,301.30 sum received by it from the oil produced (R. 101).

On appeal to the Board of Tax Appeals it was stipulated (R. 40) that the undepreciated and undepleted cost of the personal property included in the transfer was $187,418.23. The petitioner chose to treat part of the $400,000 cash payment as a return of this cost, and conceded that its claim for the 27½% allowance for depletion, if valid at all, was applicable only to the remaining $212,581.77 (R. 102). The Board of Tax Appeals concluded that the petitioner was not entitled to the depletion allowance with respect to any part of the $400,000 payment (R. 102). The Circuit Court of Appeals affirmed the decision of the Board as to this issue (R. 137–140).

ARGUMENT

The depletion deduction from "gross income from the property" permitted by the statute is a deduction from gross income realized from the production of oil on the property; it is not a deduction from income realized from the sale of the property. *Helvering* v. *Elbe Oil Land Co.*, 303 U. S. 372, 375–376; *Ortiz Oil Company* v. *Com-*

missioner, 102 F. (2d) 508 (C. C. A. 5th), certiorari denied, 308 U. S. 566; *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56, 59 (C. C. A. 10th), certiorari denied, 284 U. S. 666. The variety which marks agreements for the transfer of interests in oil-producing property consequently creates a necessity for determining in each case whether the income received by the transferor as a result of the agreement is income arising from the production of oil or from the sale of the property.

In *Anderson* v. *Helvering,* 310 U. S. 404, 408–409, this Court identified the two categories in which particular transactions must be placed. It was observed that the owner and operator of oil properties "clearly has a capital investment in the oil in place, if anyone has, and so is taxable on the gross proceeds of production and is granted a deduction from gross income as compensation for the consumption of his capital." Such an owner can, however, sell his interests outright, thus converting his capital investment into cash, severing his connection with the production of oil and gas, and rendering "inapplicable to his situation the reasons for the depletion allowance."

To the extent that owners [1] have devised methods of transfer by which they are enabled to sell

[1] For purposes of the issue raised by this case, the holder of a lease entitling him to conduct operations and to receive a substantial part of the proceeds from production may be treated as an owner. See *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364, 369; *Palmer* v. *Bender,* 287 U. S. 551, 558.

a part of their interest while retaining another part, they have created situations which, "falling between the two mentioned, have been put on one side or the other as the case arose."

In its classification of these situations to date, this Court has determined that income which the seller obtains from royalties paid out of sums realized from the production of oil represents income from a retained capital investment and is consequently subject to the allowance for depletion. *Palmer* v. *Bender,* 287 U. S. 551; *Murphy Oil Company* v. *Burnet,* 287 U. S. 299; *Burnet* v. *Harmel,* 287 U. S. 103. Where title to a specified fraction of the oil is reserved by the seller until a named sum is realized from its production and sale, the income which he receives from it is treated in the same manner as royalties, for purposes of depletion allowances. *Thomas* v. *Perkins,* 301 U. S. 655, 663. On the other hand, periodic payments of stipulated sums, combined with an agreement for profit-sharing to commence at a later date, even though the buyer is free to discontinue the payments if the productivity of the wells proves unsatisfactory, do not constitute income from a retained economic interest or capital investment entitling the seller to depletion allowance. *Helvering* v. *Elbe Oil Land Company,* 303 U. S. 372.

Where an agreement provides for a cash payment at the date of transfer, as well as for future royalties or payments to the transferor from the proceeds of a designated fraction of the oil pro-

duced, the critical question is whether the cash payment is to be treated as an "advance royalty" or "bonus", or as consideration for an outright and immediate sale *pro tanto* of the transferor's interest. This question has received varying answers by the courts, depending upon the character of the transfer agreement involved. In *Commissioner* v. *Fleming*, 82 F. (2d) 324 (C. C. A. 5th), the agreement contemplated that the transferor would receive an immediate cash payment, plus the proceeds from the production and sale of half the oil transferred until these proceeds reached a named total. The Circuit Court distinguished between these two sources of income, holding that the former arose from the sale of a capital asset and was not subject to a depletion allowance, while the latter arose from the operation of the oil wells and was subject to the allowance.

The Circuit Court of Appeals in the instant case correctly considered its decision in the *Fleming* case as controlling. There is no doubt that the agreement here reserved to the petitioner an "economic interest" in one-quarter of seven-eighths of the oil in place (which was one-half of the total interest transferred)[2] nor that the income up to $1,200,000 which he receives from the sale of that fraction of the oil is subject to the allowance for depletion. *Thomas*

[2] Except in the case of the eleventh lease, where one-quarter of seven-eighths was involved in the transfer, and petitioner reserved title to one-eighth. See pp. 3-4, *supra*.

v. *Perkins*, 301 U. S. 655. The only contest concerns the treatment of the $400,000 cash payment. It is conceded that $187,418.23 of this amount is not subject to the allowance because it represents a return to the petitioner of the cost of the personal property attached to the leaseholds. And the remaining $212,581.77 must also be treated as consideration for the sale of a capital asset, namely, the remaining one-fourth of seven-eighths of the oil in place included in the transfer, title to which was not reserved by the petitioner. Unless it is so regarded, no consideration for this quarter-interest can be found in the agreement. Nor can it be fairly construed as a "bonus" or advance payment of the contemplated receipts from the sale of the quarter-interest to which title was reserved. Cf. *Palmer* v. *Bender*, 287 U. S. 551. It is significant that not until the time of the proceedings before the Board of Tax Appeals did the petitioner indicate what portion of the $400,000 it regarded as constituting the "bonus" (R. 102). It would require an extremely strained construction to conclude that the parties to the transfer agreement *intended* that the petitioner should immediately receive $212,581.77 as an "advance royalty" or "bonus", in contemplation of future production.

The agreement therefore must be construed as providing that title to one-half the oil in place and to the personal property attached to the leaseholds should be sold outright for $400,000. The

petitioner is not entitled to the 27½% allowance for depletion as to any part of this $400,000, since it represents the consideration for the sale of a capital asset. *Helvering* v. *Elbe Oil Land Co.*, 303 U. S. 372, 375–376. It is immaterial that an "economic interest" was concededly retained in the other quarter-interest transferred and that the petitioner is entitled to an allowance for depletion with respect to the proceeds realized from the sale of the oil to which title was thus reserved.

The petitioner urges as a reason for granting the writ that the decision of the Circuit Court of Appeals, together with its earlier decisions in *Commissioner* v. *Fleming*, 82 F. (2d) 324 and *Laird* v. *Commissioner*, 97 F. (2d) 730, is in conflict: (a) with the opinion of this Court in *Palmer* v. *Bender*, *supra;* (b) with the opinion of the Circuit Court of Appeals for the Ninth Circuit in *Elbe Oil Land Co.* v. *Commissioner*, 91 F. (2d) 127, reversed 303 U. S. 372; and (c) with the decision of the United States Court of Claims in *Heep Oil Corporation* v. *United States*, 32 F. Supp. 762. We submit that these contentions are unsound.

1. *Palmer* v. *Bender*, *supra*, involved a transfer of a portion of a leasehold in consideration, *inter alia*, of a royalty chargeable against a percentage of the oil to be produced out of the entire portion of the property transferred together with an advance bonus. Here on the other hand, petitioner

created two entirely separate interests in the property; it sold one for a fixed amount, and retained an interest in the other. Obviously, the purchase price of the interest sold could not be subject to a depletion allowance, notwithstanding the applicability of the allowance to the periodic payments to be received out of the oil produced.

2. In *Elbe Oil Land Company* v. *Helvering,* 91 F. (2d) 127 (C. C. A. 9th), the transfer agreement provided: (a) that the buyer pay $350,000 in cash in 1927; (b) that it pay $400,000 in cash in each of the years 1928, 1929, and 1930; (c) that it pay $450,000 in 1931; (d) but that it might elect to abandon the purchase prior to the 1928 payment, and again, prior to the 1929 payment; (e) that after 1931, the buyer receive all the income from the property until it should be reimbursed for all its previous expenses, including the prior cash payments to the seller, totaling $2,000,000; (f) that thereafter the seller would receive one-third of the net profits resulting from production and operation. The initial $350,000 payment in 1927 exceeded the cost of the property transferred, and the seller reported the difference as taxable income. In 1928 and 1929 it claimed the 27½ percent allowance for depletion with respect to each of the $400,000 payments.

The Circuit Court of Appeals for the Ninth Circuit held that the claim was a valid one, de-

claring that the payments were indistinguishable from "bonus payments and royalties." The court regarded it as significant that until 1929 the buyer could elect to discontinue the payments, that it would continue to make them "only because of the belief that development of the oil resources of the land justified such payment," that "the whole contract was based upon the value of the oil content of the land," and that as a consequence the seller "had at all times an economic interest in the oil produced from the leased premises" (91 F. (2d) 127, at 128, 130). To the contention that *Commissioner* v. *Fleming* (82 F. (2d) 324 (C. C. A. 5th)), upon which the Circuit Court of Appeals for the Fifth Circuit relied in the instant case, required a different result, the court replied:

> If the case at bar cannot be distinguished from [*Commissioner* v. *Fleming*] * * * because of the fact that the two $400,000 payments involved here were to be optional with the purchaser, and thus were obviously dependent upon the result of exploratory operations for oil, and because of the fact that the vendee had the right to surrender the premises at any time before the payment of the second $400,000, as the Commissioner contends that it can be distinguished, we must decline to follow that decision". (91 F. (2d) 127, at 130)

Certiorari was granted by this Court because of the asserted conflict with the *Fleming* case (303 U. S. 372, 374), and the judgment was reversed on the ground that the contract "provided for an absolute sale of all the properties in question * * * and that [the seller] did not retain any interest or investment therein", and that "neither the cash payments nor the agreement for a share of the subsequent profits constituted an advance royalty, or a 'bonus' in the nature of an advance royalty" (303 U. S. at 375).

Petitioner contends that the asserted conflict between the decision of the Circuit Court of Appeals for the Ninth Circuit and the *Fleming* case was not resolved by the opinion of this Court (Pet. 3, 15). It urges that this Court simply differed with the Ninth Circuit in its appraisal of the facts of the case, but left unaffected the rule of law enunciated by the intermediate court. And since the situation in the instant case is strictly analogous to that involved in the *Fleming* case, petitioner contends that the writ should be granted here for the purpose of settling the conflict between the two rules.

We think the petitioner has misunderstood the import of this Court's decision in the *Elbe* case. The judgment of the Circuit Court was not reversed because of a disagreement over what the record showed. It was reversed because, in the

view of this Court, the two $400,000 payments in 1928 and 1929 did not represent advance royalties or bonuses. That is to say, they did not represent income from an interest reserved by the seller in any part of the oil to be produced. Not only did the rule of law embodied in this conclusion resolve any conflict between the *Fleming* case and the decision of the Circuit Court in the *Elbe* case in favor of the former; it provided the rule applicable to the instant case. For the question here as there is whether the cash payments represent income from an interest reserved by the seller, or whether they represent a *pro tanto* conversion of capital investment from oil to money.

3. The petitioner further asserts (Pet. 2, 13) that the decision below is in conflict with *Heep Oil Corp.* v. *United States,* 32 F. Supp. 762 (Ct. Cl.). In that case, the taxpayer sold producing oil property for $106,000 plus an additional sum to be paid out of one-half of the proceeds of oil or gas produced. In the year of the sale, 1930, this fraction of the proceeds amounted to $46,947.28. The taxpayer claimed and was allowed a deduction of $78,412.63, which represented the full cost of the leases and equipment disposed of. It later sought an allowance for depletion with respect to the $46,947.28. In dismissing the suit, the Court of Claims specifically stated that (p. 766):

> We do not decide whether or not plaintiff is entitled to depletion. We hold only that it is not entitled under the instrument in this case to deduct both the cost to it of the property and depletion also.

The court then proceeded to point out, purely by way of *dictum,* that if a depletable oil interest were retained, the depletion must be computed with respect to the entire amount paid and not merely as to the deferred payments to be made out of proceeds from the oil produced. It is obvious that the decision was limited to the holding that there was no overpayment of tax. Thus, the decision was in the Government's favor. Accordingly, petitioner's criticism here (Pet. 14) of the Government's failure to apply for certiorari in the *Heep* case is without merit.

It may be added that whatever significance might otherwise attach to this dictum in the *Heep* case, is virtually eliminated by the squarely contradictory holding by the same court in *Berry Oil Co.* v. *United States,* 25 F. Supp. 97, certiorari denied, 307 U. S. 634.

CONCLUSION

The case raises no new questions of general importance but involves merely the application to its peculiar facts of principles recently settled by this Court. The decision of the court below is correct.

There is no conflict of decisions. The petition should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

NO. 191

ROESER & PENDLETON, INC., *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING OF DENIAL OF CERTIORARI

(October 13, 1941)

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Commercial Recorder—Fort Worth, Texas—2-5398

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(October 13, 1941)

TO THE HONORABLE, THE SUPREME COURT OF THE UNITED STATES:

In accordance with Supreme Court Rule 33, this Petition for Rehearing is filed within twenty-five days from the date, October 13, 1941, of denial by this Court of Petition for Certiorari to review judgment of the United States Circuit Court of Appeals reported in 118 Fed. (2d) 469—See R. 138-142.

Petitioner, while conceding that, under Supreme Court Rule 38-5 (b), a review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special

and important reasons therefor, feels that there are impelling reasons why this Court should grant a rehearing herein.

A careful search of the cases will probably show few instances in which there has been as much conflict in the holdings of the Court of Claims and the several Circuit Courts of Appeals as there has been in this case upon the question of whether a seller of a producing oil and gas lease, for part cash and a stipulated payment out of a reserved portion of the oil, is entitled to the statutory 27½% depletion on the cash payment received from the sale, treating the cash payment as a bonus or advance royalty.

FIRST, the Fifth Circuit, in the *Fleming Case*, 82 F. (2d) 324, on Mar. 7, 1936 held that the Seller was *not* entitled to the depletion allowance. Senior Judge Foster dissented.

NEXT, five members of the U. S. Board of Tax Appeals, on Nov. 13, 1936, in the *Roy H. Laird Case*, 35 B. T. A. 75 (dissenting) declined to follow the majority decision of the Fifth Circuit in the *Fleming Case*.

NEXT, the Ninth Circuit, on June 21, 1937, in the *Elbe Oil Company Case*, 91 Fed. (2d) 127, declined to follow the majority decision of the Fifth Circuit in the *Fleming Case*.

NEXT, the Supreme Court granted Certiorari in the *Elbe Oil Company Case* (303 U. S. 372, 374) to resolve the conflict between the decision of the Ninth Circuit Court in that case and the majority decision of the Fifth Circuit Court in the *Fleming Case*.

NEXT, the Supreme Court, in deciding the *Elbe Oil Company Case* (303 U. S. 372) found it unnecessary to decide whether the holding of the Ninth Circuit Court in that case was in conflict with the Fifth Circuit Court's holding in the *Fleming Case*, inasmuch as the Supreme Court found that the facts in the *Elbe Case* were different from the facts in the *Fleming Case*, since in the former there was an outright sale, with no reserved interest in the minerals, whereas, in the latter, the reverse was the case.

NEXT, the Court of Claims, on May 6, 1940, in the *Heep Oil Corporation Case*, 32 Fed. Supp. 762, declined to follow the majority decision of the Fifth Circuit in the *Fleming Case.*

FINALLY, the Fifth Circuit, in the instant case, reaffirmed and followed its previous decision in the *Fleming Case*, and the Supreme Court, on October 13, 1941, refused Certiorari to review its decision. This petition for rehearing is addressed to its action in so doing.

From the foregoing, it will be observed that Senior Judge Foster of the Fifth Circuit (dissenting) in the *Fleming Case*, 82 F. (2d) 324, five members of the Board of Tax Appeals (dissenting) in the *Roy H. Laird Case*, (35 B. T. A. 75), the Ninth Circuit in the *Elbe Oil Company Case*, 91 Fed. (2d) 127, the Court of Claims in the *Heep Oil Corporation Case*, 32 Fed. Supp. 762, have rendered opinions in said cases, which are in direct conflict with the decision of the Fifth Circuit Court in the *Fleming Case*, supra, and in Petitioner's case, now before this Court on rehearing.

It is true that Senior Judge Foster in cases following *Commissioner v. Fleming*, 82 Fed. (2d) 324, agreed with the majority, in line with the *Fleming Case*; however, the Ninth Circuit Court in the *Elbe Case*, and the Court of Claims in the *Heep Case*, have not receded from their difference with the Fifth Circuit on the question here involved.

GROUNDS FOR REHEARING

Ground One: Since *Hamilton Brown Shoe Co. v. Wolf Bros.*, 240 U. S. 251 (see Honnold's Supreme Court Law, Vol. 1, p. 269), it has been settled that the Supreme Court's refusal of certiorari is not equivalent to an affirmance of the decree; hence the Supreme Court's denial of certiorari in a Federal tax suit does not settle the issue, but leaves it open for future controversy and litigation between the Treasury Department and taxpayers. This situation is not only confusing to the Treasury Department and to the taxpayer alike, but renders difficult the orderly administration of the Federal Income Tax Law. Petitioner submits that it is to the public interest in the collection of income taxes to finance the operations of the Federal Government, for the courts to speedily clarify and finally adjudicate questions as to which there may be serious doubt, and especially those concerning which there has been so much difference of opinion as in the one involved in this case.

Ground Two: The Petition for Certiorari involves an important Federal question, which concerns the right of a lessee, in making a sale of an oil property for a stipulated amount of cash, and the retention of

"an economic interest of a stated portion of the oil and gas in place — in the nature of an overriding royalty, to claim the statutory 27½% depletion allowance on the cash received from the sale, treating such cash, as a return *pro tanto* of the seller's capital investment in such oil in anticipation of its extraction." *(Palmer v. Bender*, 287 U. S. 551.)

Petitioner respectfully submits that, with respect to the above Federal question, the decision of the United States Circuit Court of Appeals for the Fifth Circuit (R. 138-142) is in direct conflict with the hereinafter mentioned decision of the Circuit Court of Appeals in the *Heep Case*, and the decision of the Ninth Circuit in the *Elbe Oil Company Case;* and such being the case, in order to settle the conflict once and for all, and not to leave the question open for further controversy between the Treasury Department and taxpayers, this Court should grant this Petition for Rehearing, as well as the Petition for Certiorari, and decide the question.

Petitioner knows of no better way to demonstrate a conflict between two decisions, than by quoting from each of them. Therefore, with permission of this Court, the opinion of the Court of Claims in the *Heep Case*, and the opinion of the Ninth Circuit in the *Elbe Case*, will be quoted and compared with the opinion of the Fifth Circuit in the instant case, so that this Court may quickly observe the direct conflict that exists between the Court of Claims and the Ninth Circuit on the one hand, and the Fifth Circuit on the other, with respect to the important tax question here involved.

FIRST CASE IN CONFLICT:

The United States Court of Claims in *Heep Oil Corporation v. United States*, 32 Fed. Supp. 762, decided May 6, 1940, in its opinion said:

> "We are further of the opinion that if it is entitled to depletion, this depletion must be computed with respect to the *entire amount* paid and not merely on the deferred *payments* to be made out of the oil produced. (Italics ours.)
>
> "In Commissioner v. Fleming, 82 F. (2d) 324, the majority of the court in the Fifth Circuit held that depletion should be computed only on the deferred payments, on the theory that that part of the oil out of which the deferred payments were to be made had not been sold. *Circuit Judge Foster dissented.* The Ninth Circuit, on the other hand, in the case of Elbe Oil Land Development Company v. Commissioner, 91 F. (2d) 127, held that depletion should be computed both on the deferred payments and the cash payment as well. Judge Garrecht dissented, but not on this ground. The Supreme Court reversed the Circuit Court of Appeals (Helvering v. Elbe Oil Land Development Company, 303 U. S. 372, 58 S. Ct. 621, 82 L. Ed. 904), but on the ground that the transaction there was an absolute sale of the leasehold, with no reservations to the grantor of any economic interest in the oil situated thereon.
>
> "If by the instrument in the case before us, properly construed, the plaintiff had conveyed all of the land except a portion which it reserved to itself, it would follow that it was entitled to depletion only on the oil reserved, but, as we have said heretofore, we think the conveyance here

was of all the oil, except for the 1/32nd part of that produced from sands below the 3800-foot level. In such case, if plaintiff's net income is to be computed by the deduction of depletion from the amount received, rather than the cost of the property, *it must be computed with respect to the entire amount received. The cash payment must be treated as a bonus or advance royalty.* Burnet v. Harmel, 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199; Murphy Oil Co. v. Burnet, 287 U. S. 299, 53 S. Ct. 161, 77 L. Ed. 318." (Italics ours.)

The conflict between the holding of the Court of Claims in the *Heep Case*, supra, and the holding of the Fifth Circuit in the instant case clearly appears from the following statement contained in the Fifth Circuit Court's opinion in the instant case, 118 Fed. (2d) 462, 463:

"The taxpayer contends that it should have been allowed statutory depletion of 27½% on the $212,-581.77 of the cash payment received by it from the sale of its interest in the oil and gas leases. This contention is also without merit. The Board properly disallowed percentage depletion with respect to the cash payment received by the taxpayer. Commissioner v. Fleming, 5 Cir., 82 F. (2d) 324; Laird v. Commissioner, 5 Cir., 97 F. (2d) 730; Blankenship v. United States, 5 Cir., 95 F. (2d) 507; Cf. Anderson v. Helvering, 310 U. S. 404, 60 S. Ct. 952, 84 L. Ed. 1277."

Respondent, on page 15 of his brief filed in this Court, says that the holding of the Court of Claims in the *Heep Case*, as above set out, is "dictum." Further that whatever significance might otherwise attach to the holding in the *Heep Case*, is virtually eliminated

by the squarely contradictory holding by the same Court in *Berry Oil Company v. United States*, 25 Fed. Supp. 97; certiorari denied 307 U. S. 634. As pointed out on page 50 of Petitioner's brief, the *Berry Case* involved an outright sale, with no reservations of minerals, as was the case in the *Elbe Oil Company*, 303 U. S. 372. Therefore, the facts in the *Berry Oil Company Case* and the *Heep Case*, both by the Courts of Claims, involved wholly different facts, because in the *Heep Case*, the Court of Claims in its opinion said, "We think the conveyance here was of all of the oil except for the 1/32nd part of that produced from sands below the 3800-foot level," whereas, in the *Berry Case*, the Court of Claims held there was an outright sale and no reservation of minerals.

SECOND CASE IN CONFLICT:

The United States Circuit Court of Appeals for the Ninth Circuit, in the case of *Elbe Oil Company v. Commissioner*, 91 Fed. (2d) 127, decided June 21, 1937, in its opinion said:

> "In Commissioner v. Fleming, supra, a similar question was presented. The cash payment was $1,000.00, and a second million was to be paid from the proceeds of the oil derived from the premises. It was held by a majority of the Court that the seller of the land was not entitled to a depletion deduction from the $1,000.00 in cash which he had received, but that he was entitled to a deduction from the payments derived from 'one-fourth of oil, gas and other minerals produced,' etc. Circuit Judge Foster dissented upon the ground that, under the decision of the Su-

preme Court in Palmer v. Bender, supra, there should also be a deduction for depletion on cash payment 'since the taxpayer retained an economic interest in the oil in place'." * * *

"If the case at bar cannot be distinguished from the decision of the Fifth Circuit Court of Appeals in Commissioner v. Fleming, supra, because of the fact that the two $400,000 payments involved here were to be optional with the purchaser, and this were obviously dependent upon the result of exploratory operations for oil, and because of the fact that the vendee had the right to surrender the premises at any time before the payment of the second $400,000, as the Commissioner contends it can be distinguished, *we must then decline to follow that decision. In the case at bar it is entirely clear that no matter what language we use in describing the nature of the transaction between the petition and the Honolulu Company, the petition had at all times an economic interest in the oil produced from the leased premises and was therefore entitled to a depletion allowance upon the cash paid as well as the oil produced.*" (Italics ours.)

As stated above, the Circuit Court of Appeals for the Fifth Circuit in Petitioner's case, on this same question, held directly contrary to the decision of the Ninth Circuit Court in the *Elbe Oil Company Case*, above set out, as shown by the following quotation from the Fifth Circuit's opinion in the instant case:

"The taxpayer contends that it should have been allowed statutory depletion of 27½% on the $212,581.77 of the cash payment received by it from the sale of its interest in the oil and gas

leases. This contention is also without merit. The Board properly disallowed percentage depletion with respect to the cash payment received by the taxpayer. Commissioner v. Fleming, 5 Cir., 82 F. (2d) 324; Laird v. Commissioner, 5 Cir., 97 F. (2d) 730; Blankenship v. United States, 5 Cir., 95 F. (2d) 507; Cf. Anderson v. Helvering, 310 U. S. 404, 60 S. Ct. 952, 84 L. Ed. 1277."

Ground Three: Inasmuch as the Supreme Court granted certiorari (303 U. S. 372, top p. 374) in the *Elbe Oil Company Case* to determine the asserted conflict between the decision in that case by the Ninth Circuit Court, and the decision of the Fifth Circuit Court in the case of *Commissioner v. Fleming*, 82 F. (2d) 324, *upon the question here involved*, and since this court held, in deciding the *Elbe Oil Company Case*, 303 U. S. 372, that the facts in said case disclosed that the seller retained no economic interest in the oil in place, but on the contrary, made an outright sale, with respect to which no depletion was allowable, *it therefore follows that the conflict between the holdings of the Ninth Circuit and the Fifth Circuit Courts was not resolved by this Court*, because the facts were not found to be the same. Petitioner therefore respectfully submits that, if the question here involved was of sufficient importance to justify the Supreme Court in granting certiorari in the *Elbe Oil Company Case* to determine an asserted conflict between the decision in that case and the decision of the Fifth Circuit Court in the *Fleming Case* (which conflict was not decided because the facts in both cases were not the same), it is therefore equally important that this court grant certiorari in the instant case, so that the conflict be-

tween the holding of the Ninth Circuit in the *Elbe Case*, and the Fifth Circuit in this case, and the holding of the Court of Claims in the *Heep Case*, and the Fifth Circuit Court's holding in this case, may be resolved. It is submitted that, for this court to leave the matter further in suspense, is demoralizing to the effective administration of the income tax laws, alike to the Commissioner, as well as to taxpayers.

Ground Four: When the question here involved was first before the Fifth Circuit in the *Fleming Case*, 82 Fed. (2d) 328, Senior Judge Foster dissented from the majority view, saying:

> "I agree with the conclusion of the majority of the court as to the allowance of a deduction for depletion on the income received by the taxpayer out of the proceeds of oil produced from the lease. *However, I think we should go further and allow a deduction for depletion on the cash payment, not dependent on the production of oil, since the taxpayer retained an economic interest in the oil in place.* Palmer v. Bender, 287 U. S. 551, 53 S. Ct. 225, 77 L. Ed. 489. I therefore respectfully dissent." (Italics ours.)

Following the majority decision of the Fifth Circuit in the *Fleming Case*, supra, five members (Leech, Smith, Morris, Van Forsan and Tyson) of the U. S. Board of Tax Appeals, in the *Roy H. Laird Case*, 35 B. T. A. 75, at pages 78-79 (dissenting), declined to follow same, saying:

> "I think the rule in such cases is that when the taxpayer retains an economic interest in the oil in place, the bonus or cash consideration, from whatever the payor's source, as well as the de-

ferred payments from the oil, are gross income to the owner from that retained economic interest, and are, therefore, subject to the depletion allowance. Palmer v. Bender, supra; Helvering v. Commissioner, supra; Burnet v. Harmel, 287 U. S. 103; Welch v. Obispo Oil Co., 61 Fed. (2d) 1045; Helvering v. Falk, 291 U. S. 183; Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886.

"Here the retention of any 'economic interest in the oil in place' may be debatable. However, I agree with the Fleming case and the majority opinion of the Board here that the taxpayer did retain such an interest. Commissioner v. Elliott Petroleum Corporation, 82 Fed. (2d) 193; Chester Addison Jones, 31 B. T. A. 55; aff'd., 82 Fed. (2d) 329; Commissioner v. Williams, 82 Fed (2d) 328; Alexander v. Continental Petroleum Co., 63 Fed. (2d) 927. *But, since he did retain such an economic interest, I think that the bonus, as well as the deferred payments, were income from the economic interest, and both are, therefore, depletable. Palmer v. Bender, supra; Herring v. Commissioner, supra.*" (Italics ours.)

It is indeed difficult to find a comparable situation where there has been such diversity of opinion as on the question here involved; and unfortunately, both for the Collector and taxpayer, not yet finally decided by this Court.

Ground Five: On October 27, 1941, this Court denied Petition for Writ of Certiorari in *MeLean v. Commissioner of Internal Revenue*, 120 Fed. (2d) 942, decided by the Fifth Circuit on June 20, 1941. In the opinion of the Fifth Circuit Court in that case, the

statement is made that the *Elbe Case* was decided on the basis that there was no reservation of royalty and no retention of ownership of an interest in the minerals in place; there being only a personal covenant to pay the taxpayer, not out of minerals in place, but out of the net proceeds of a processing or manufacturing operation. This language of the Fifth Circuit reinforces and reemphasizes the contention heretofore made by Petitioner that this Court, in deciding the *Elbe Case*, 91 Fed. (2d) 127, found it unnecessary to resolve the conflict between the Ninth Circuit's decision in the *Elbe Case* and the Fifth Circuit's decision in the *Fleming Case*, since the facts in said cases were entirely different.

Petitioner is informed that Petition for Rehearing will soon be filed in the application for certiorari in the *McLean Case*. Inasmuch as the Petitioner in that case is contending that the transaction there involved is not governed by *Palmer v. Bender*, 287 U. S. 551, and Petitioner in the instant case is asserting that its right to the 27½% statutory depletion is based upon and governed by the principles announced in *Palmer v. Bender*, this Court has a fine opportunity of granting petitions for rehearing in both the instant case and the *McLean case*, to review its holding in *Palmer v. Bender*, as explained in *Anderson v. Helvering*, 310 U. S. 404, and thus make crystal clear to the Treasury Department, as well as to taxpayers the meaning and effect, and the extent to which the "economic interest" doctrine in *Palmer v. Bender*, should be applied. Headway along these lines was made by the court in *Anderson v. Helvering*, supra, but it is respectfully submitted, a further review and consid-

eration by this court of the application of the economic interest doctrine would be most helpful to everyone affected by the income tax laws of the United States.

CONCLUSION

As hereinbefore pointed out, since this court felt that the depletion question here involved was sufficiently important to justify the granting of a review on certiorari in the *Elbe Case*, 91 F. (2d) 127, in order to resolve a conflict in decisions between the Ninth Circuit in the *Elbe Case*, and the Fifth Circuit in the *Fleming Case*, and since this court found it unnecessary in deciding the *Elbe Case*, 303 U. S. 372, to resolve such conflict, inasmuch as the facts in the *Elbe Case* were found to be different from those in the *Fleming Case*, Petitioner respectfully submits that it is now just as important, in the administration of the Federal income tax law for this court to resolve the conflict on the same question which now exists between the decisions of the Court of Claims in the *Heep Case*, the Ninth Circuit in the *Elbe Case*, and the Fifth Circuit in this case.

Respectfully submitted,

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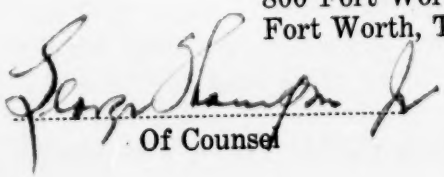

Of Counsel

CERTIFICATE

I, George Thompson, Jr., do hereby certify that the foregoing Petition for Rehearing is presented in good faith, and not for delay.